

Papua New Guinea Economic Briefing

The challenge of turning the last days of the boom into lasting improvements in living standards

Tim Bulman

Country Economist

The World Bank in Papua New Guinea

Jonathon Kirkby

Senior Investment Policy Officer, Investment Climate

The International Finance Corporation in Papua New Guinea

December 19, 2012

Business Council of PNG, Port Moresby

www.worldbank.org/png



The World Bank Group
in Papua New Guinea

What we'll be talking about

The challenge of turning the last days of the boom into lasting improvements in living standards

- 1. PNG has enjoyed a transformational decade**
 - ▶ But the driving forces are approaching exhaustion...
 - ▶ and PNG's human development needs—and business opportunities—remain enormous
- 2. The government is looking to broaden and extend this boom**
 - ▶ But these efforts bring **risks**, as PNG's own history shows
 - ▶ ...and the resource-intensive type of growth PNG is experiencing brings special challenges
- 3. So the focus needs to be on doing things smarter:**
 - ▶ Improving the effectiveness of spending
 - ▶ Making the **business climate more supportive** of Papua New Guinean businesses

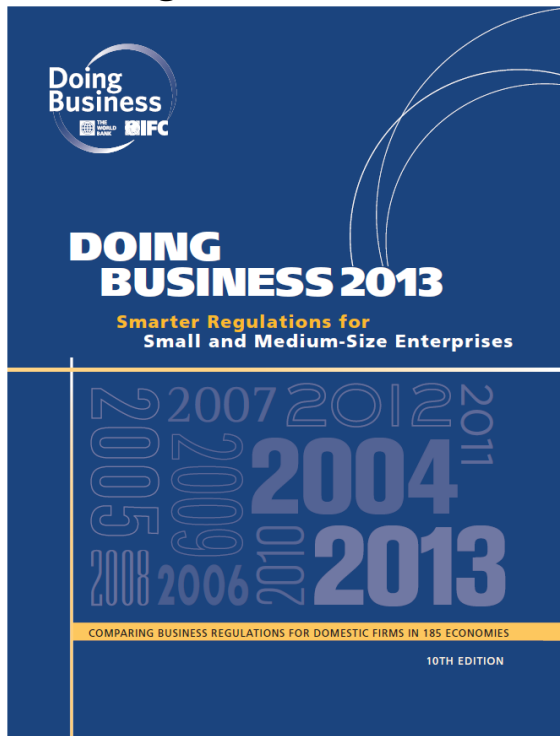


What we'll be talking about

The link to the global story

We'll be drawing on two just-launched World Bank Group publications:

Doing Business, 2013



www.doingbusiness.org

East Asia & Pacific Economic Update



www.worldbank.org/eapupdate



The World Bank Group
in Papua New Guinea

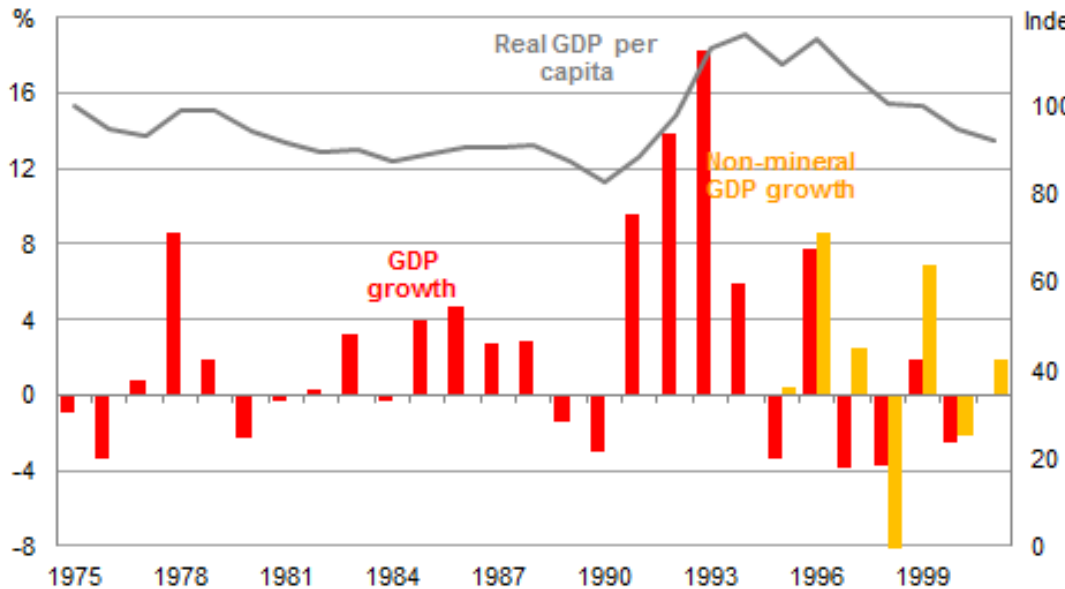
PNG's transformational decade

PNG's transformational decade

Where we were 10 years ago...

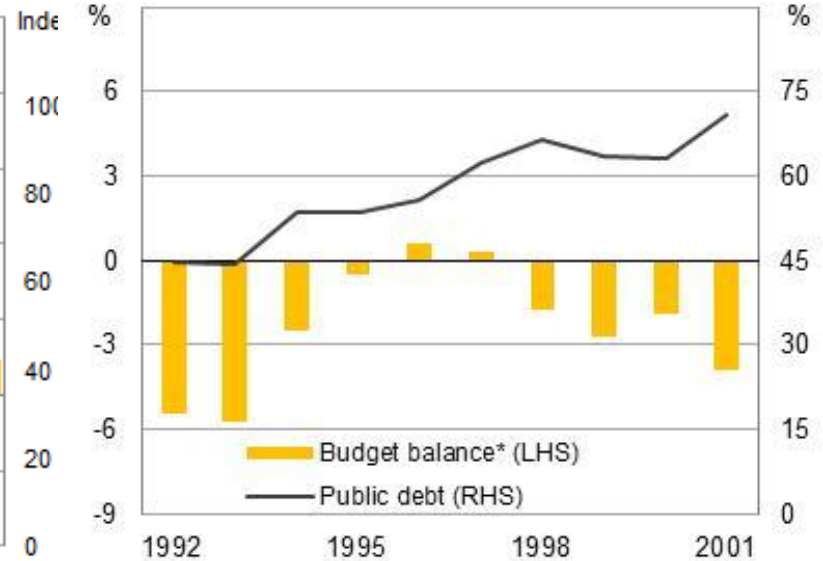
Sliding incomes, low & volatile growth

(annual growth and GDP per capita, 100 in 1975)



A deteriorating fiscal position

(percent of GDP)

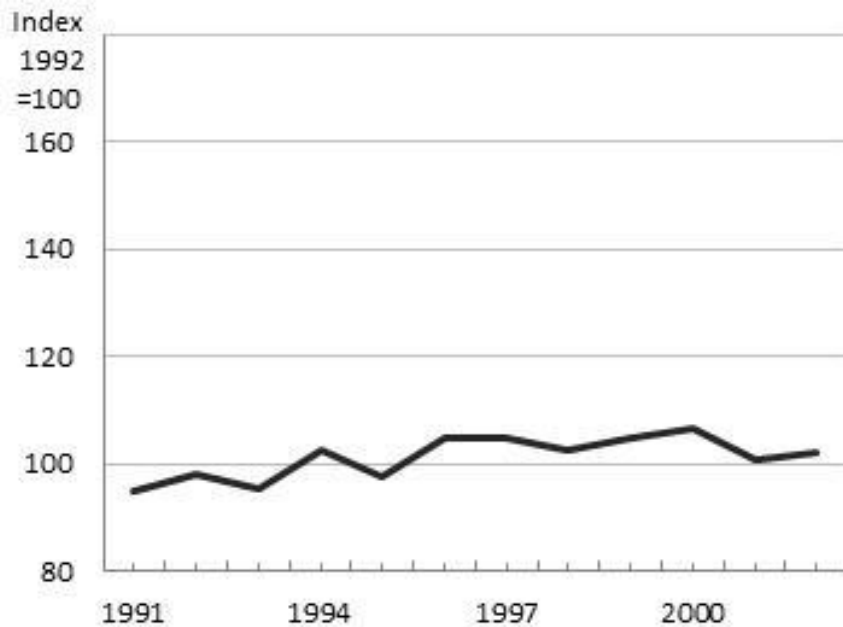


PNG's transformational decade

Where we were 10 years ago...

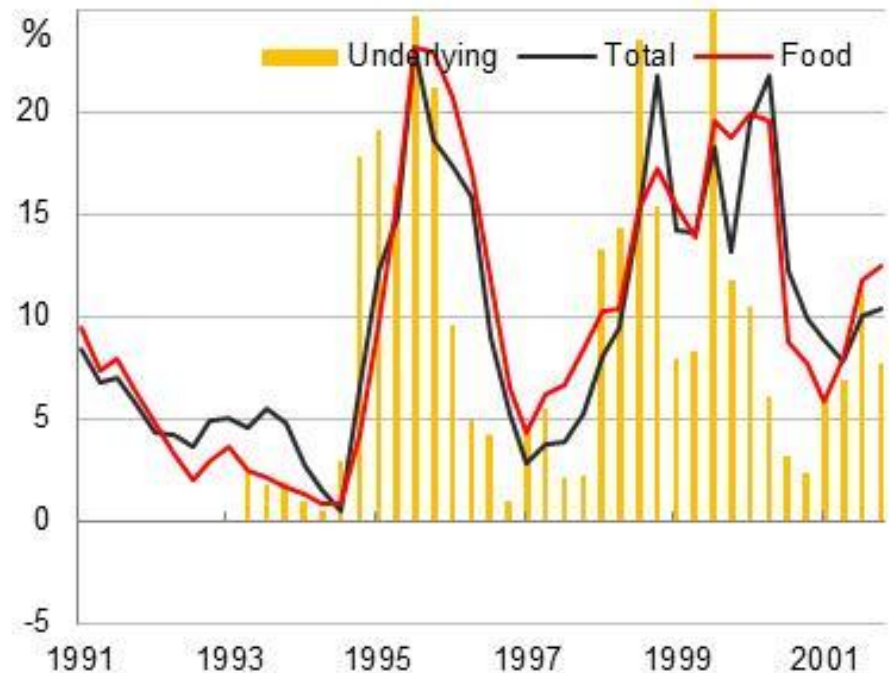
Stagnant employment

(formal employment, indexed 100 in to 1992)



....and fast-rising prices

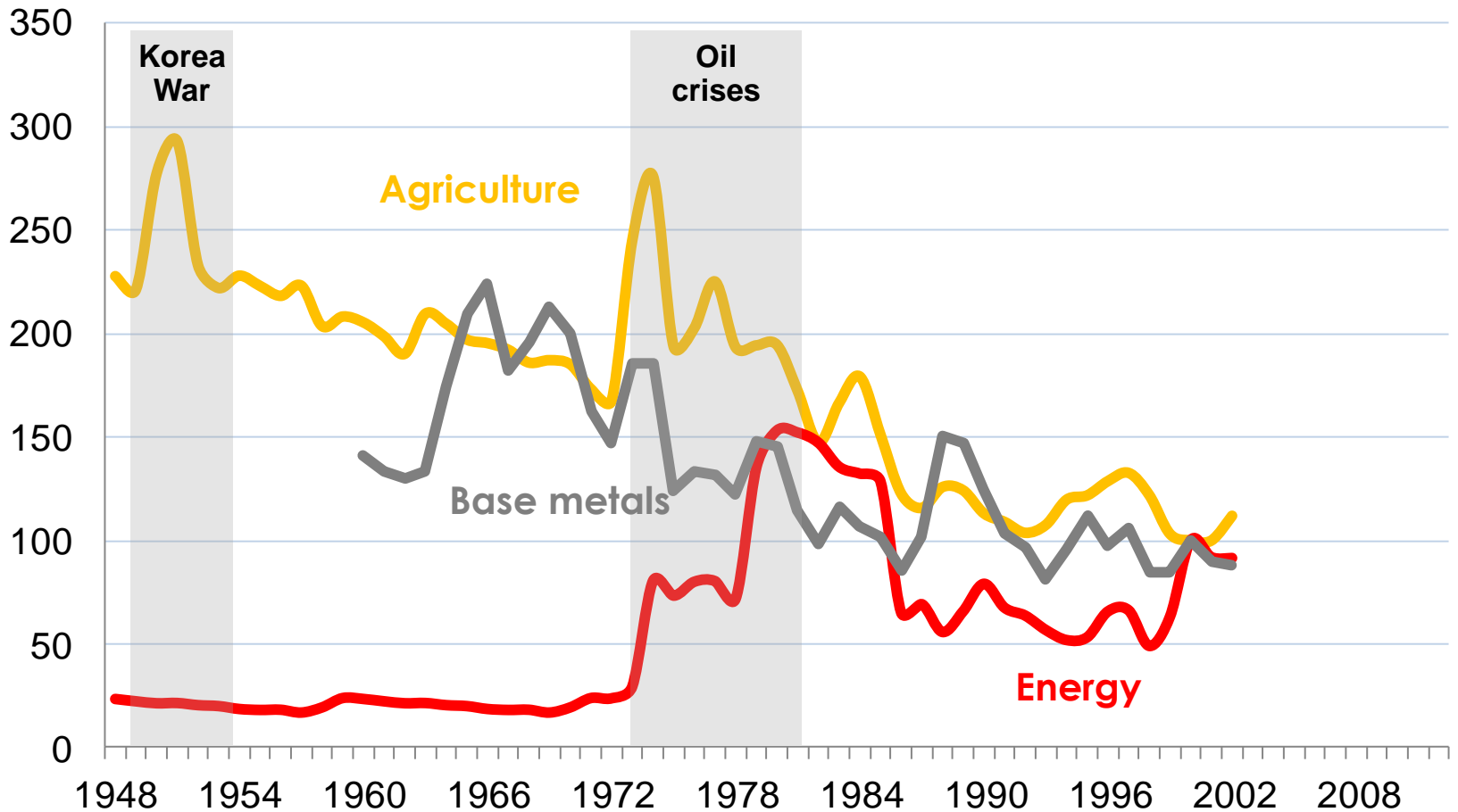
(year-on-year growth)



PNG's transformational decade

Where we were 10 years ago...

...after all, in 2002, commodity-reliant economies were doomed to incomes falling forever

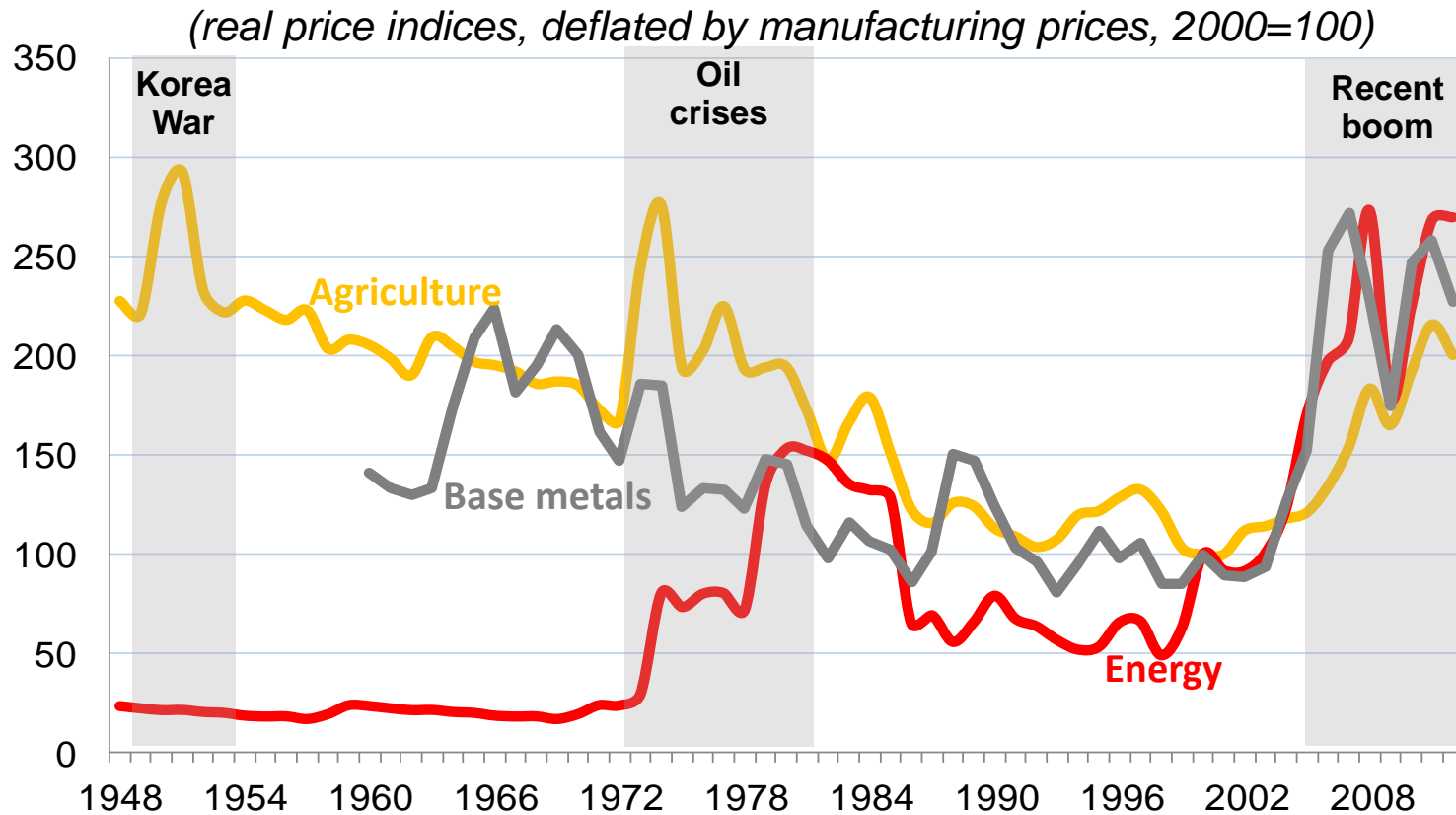


PNG's transformational decade *...and then something changed...*



PNG's transformational decade

PNG has enjoyed a series of positive external shocks



Source: World Bank DECPG



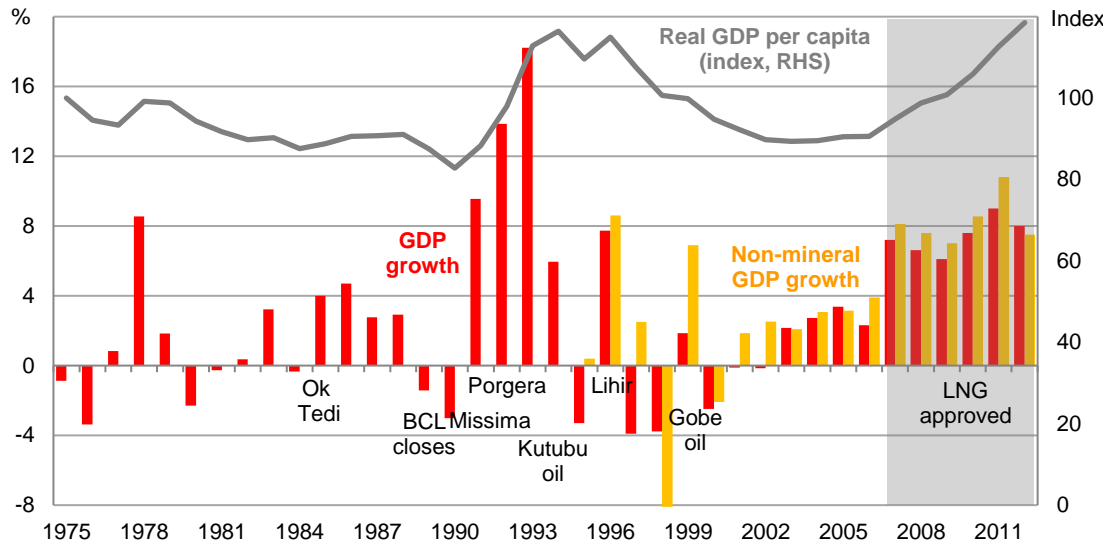
The World Bank Group
in Papua New Guinea

Sources: World Bank DEC

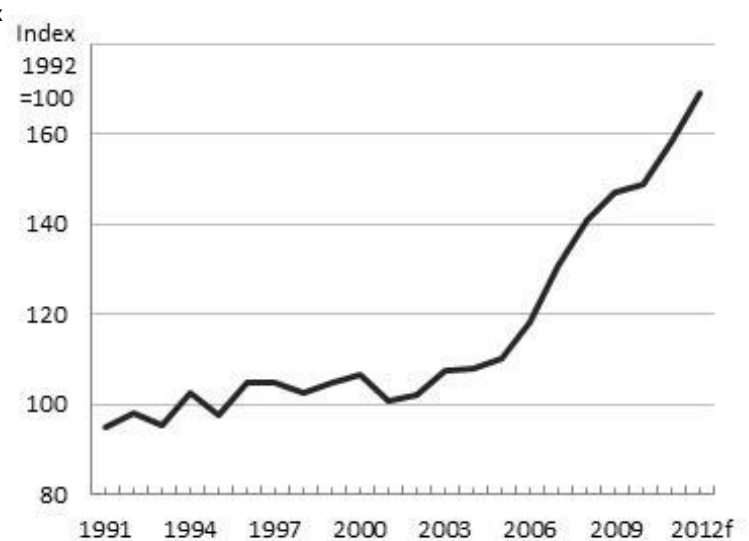
PNG's transformational decade

...and the rest is history...stronger and 'better quality' growth

Stronger and less volatile output growth ...driven by the non-resource sectors



...driving a surge in formal employment opportunities

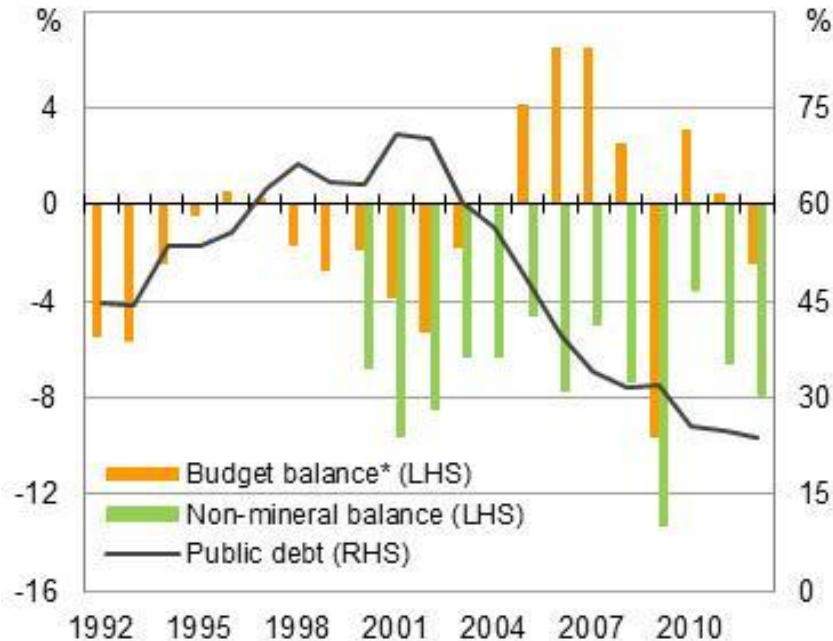


PNG's transformational decade

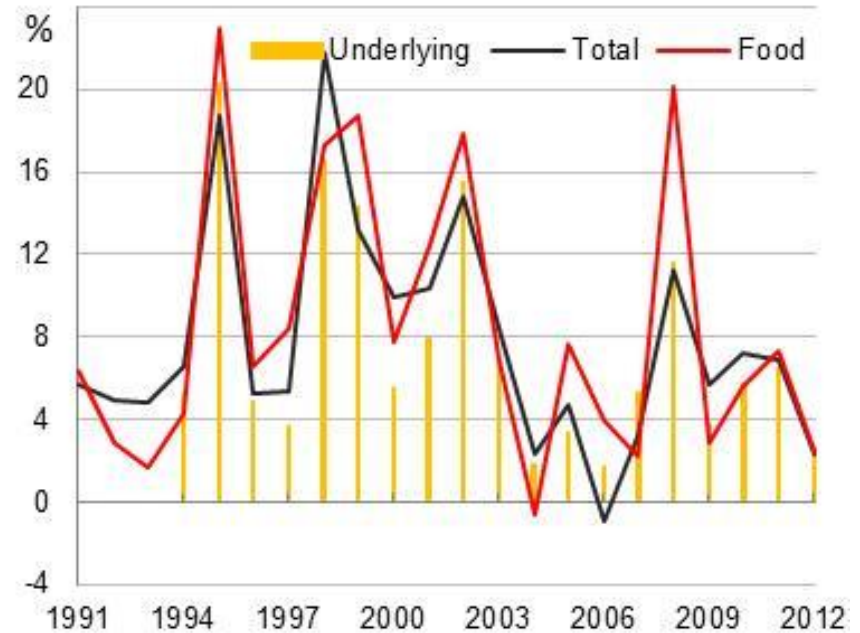
...and far healthier government finances

Improved public finances

(budget balance and public debt, percent of GDP *not including* contingent and off-balance-sheet liabilities, currently near 20% of GDP)

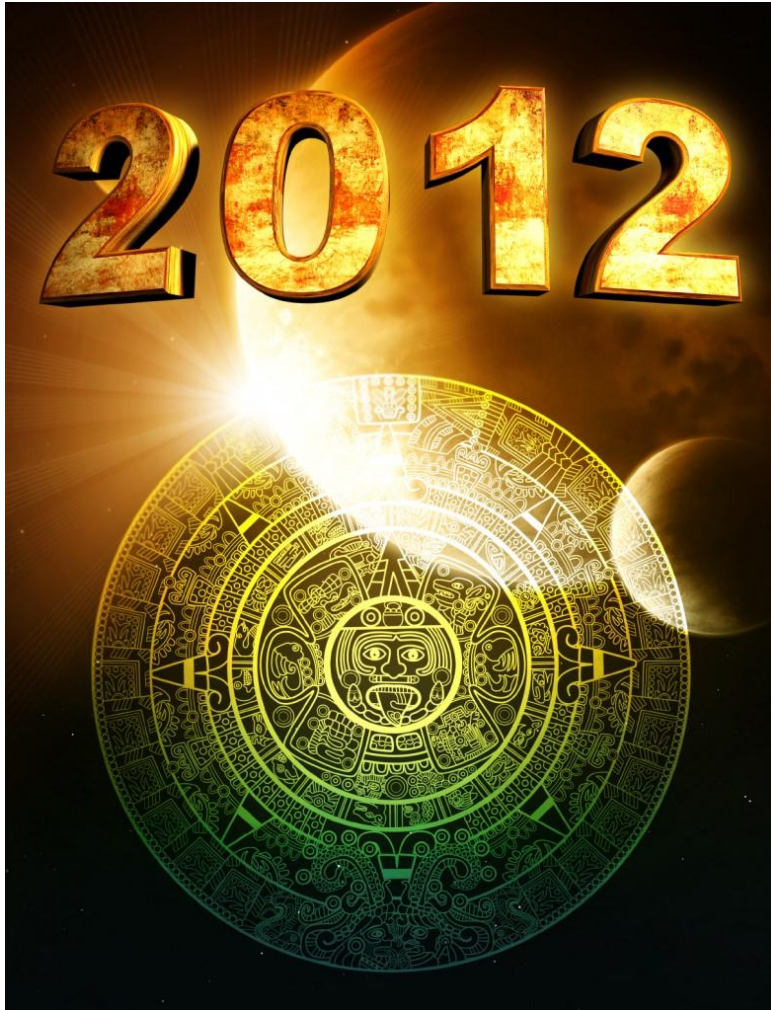


...and slower price growth
(year-on-year inflation)



PNG's transformational decade

While a lot of the talk of armageddon right now is a bit over-hyped...

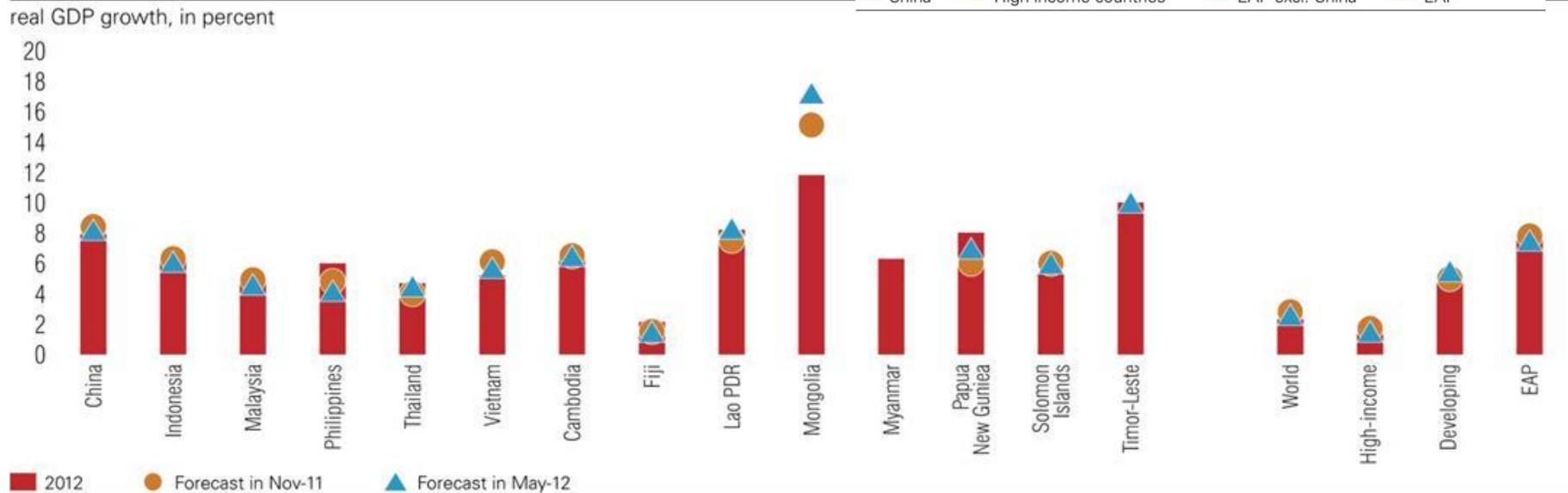
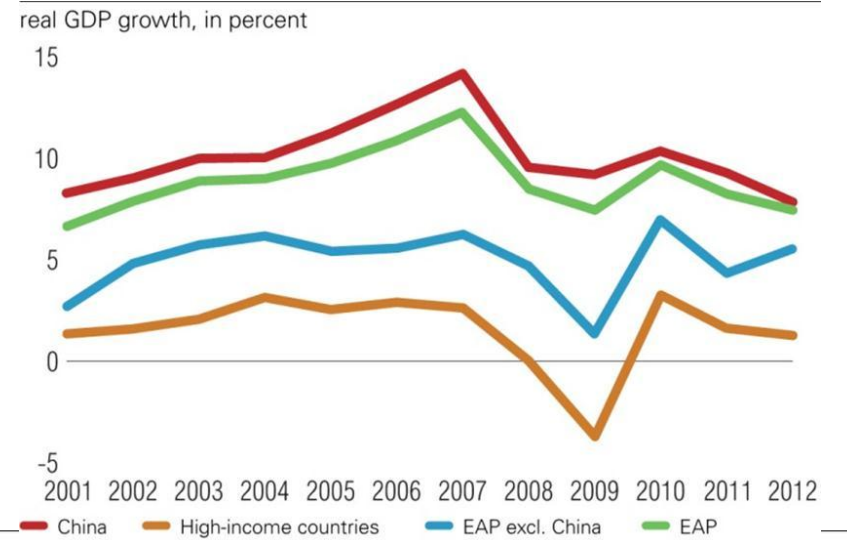


It is likely that the end is near for PNG's transformational decade

The last days of the boom

Growth in the region has slowed – although by less than expected

- ▶ **Growth has slowed globally**
 - ▶ But our region remains relatively resilient
 - ▶ And the slowdown has been less than expected

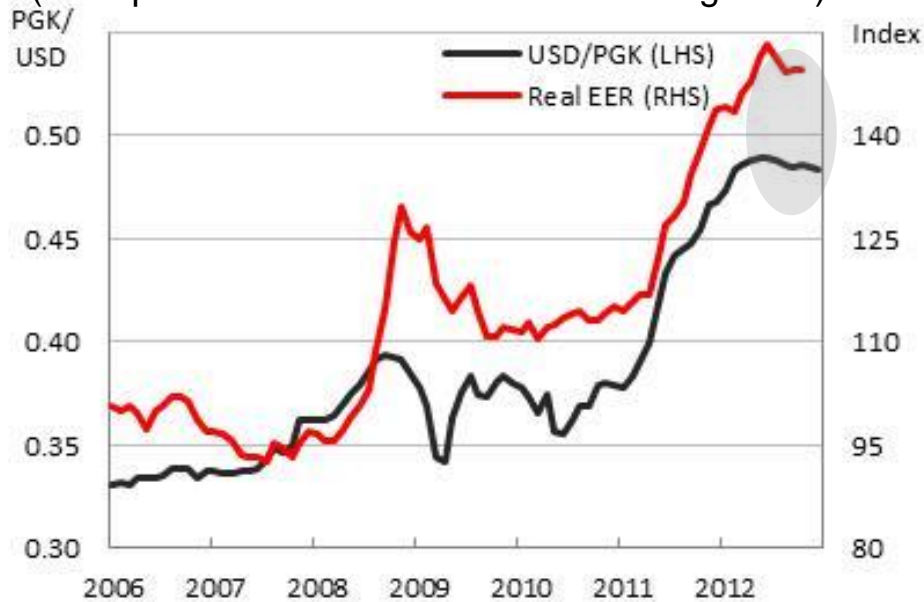


The last days of the boom

...but this is lowering PNG's export prices, amplified by the stronger Kina

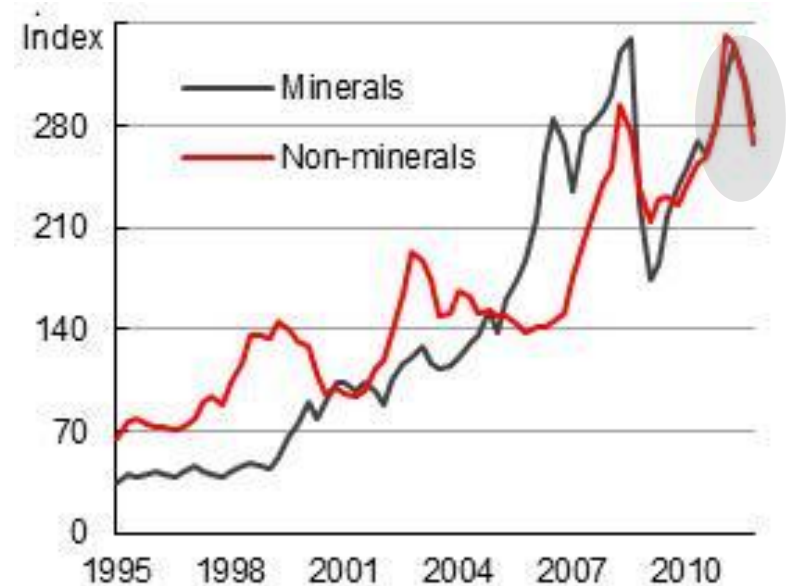
The strength of the Kina

(PGK per USD and real effective exchange rate)



...and weaker international commodity prices

(PNG's export prices, in PGK terms)



► ...are **dragging incomes** and spending power...



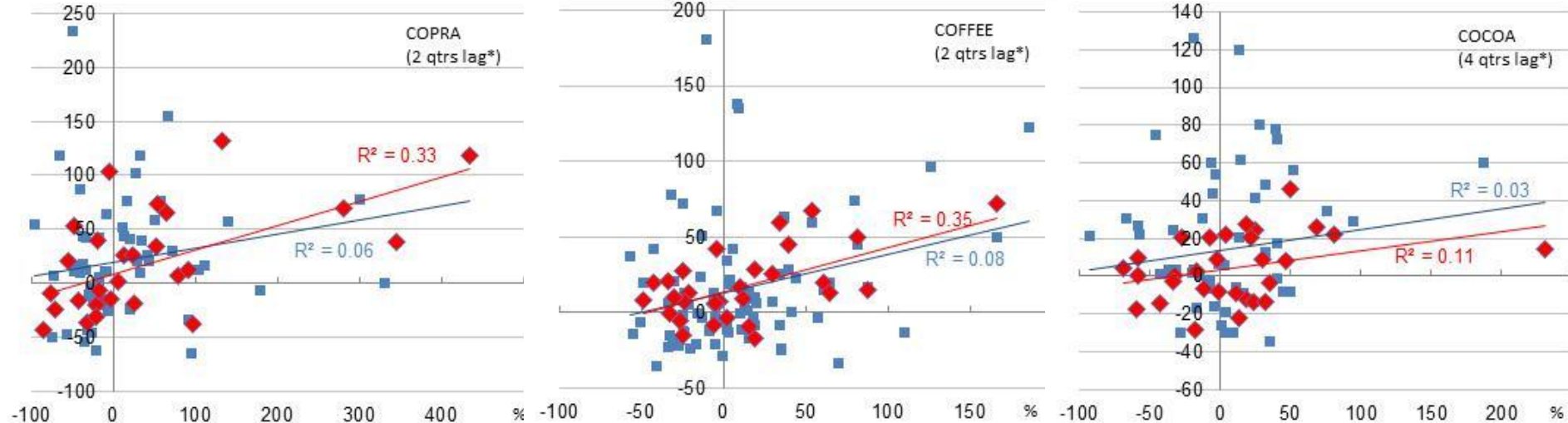
The last days of the boom

...especially effecting cash crop farmers

- ▶ The incomes of cash crop farmers are particularly sensitive to movements in prices, as farmers cut production when prices fall

- ▶ Especially copra and coffee farmers, and especially more recently

(year-on-year change in prices and sales)

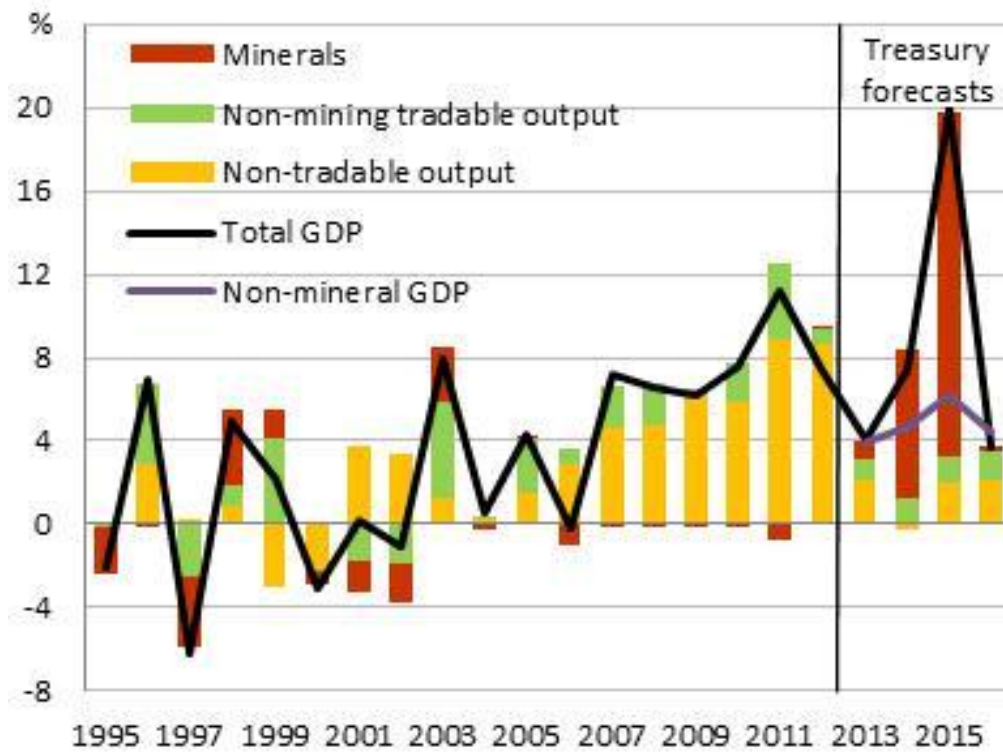


The last days of the boom

GDP growth is set to slow markedly

- ▶ Together, these factors suggest markedly slower growth over the coming years
 - ▶ especially excluding the impact of PNG-LNG on the headline GDP statistics

(year-on-year output growth and contributions)



The last days of the boom

PNG's expected slowdown contrasts with acceleration expected elsewhere

percent change form a year earlier

	2010	2011	Forecast			Changes from May-12 (in percentage points)	
			2012	2013	2014	2012	2013
East Asia	9.3	7.1	5.8	6.6	6.6	-0.5	-0.4
Developing East Asia	9.7	8.3	7.5	7.9	7.6	-0.1	-0.1
China	10.4	9.3	7.9	8.4	8.0	-0.3	-0.2
Indonesia	6.2	6.5	6.1	6.3	6.6	0.0	-0.1
Malaysia	7.2	5.1	5.1	5.0	5.1	0.5	-0.1
Philippines	7.6	3.9	6.0	6.2	6.4	1.8	1.2
Thailand	7.8	0.1	4.7	5.0	4.5	0.2	0.0
Vietnam	6.8	5.9	5.2	5.5	5.7	-0.5	-0.8
Cambodia	6.0	7.1	6.6	6.7	7.0	0.0	0.0
Fiji	0.1	1.9	2.1	2.2	2.3	0.6	0.5
Lao PDR	8.5	8.0	8.2	7.5	7.5	-0.1	0.0
Mongolia	6.4	17.5	11.8	16.2	12.2	-5.4	4.4
Myanmar	5.3	5.5	6.3	6.5	6.6
Papua New Guinea	7.6	9.0	8.0	4.0	7.5	1.0	-1.0
Solomon Islands	7.8	10.5	5.3	4.0	3.3	-0.7	0.0
Timor-Leste	9.5	10.6	10.0	10.0	10.0	0.0	0.0
Developing East Asia excl. China	7.0	4.4	5.6	5.7	5.8	0.4	0.1
<i>Assumptions about the external environment:</i>							
World	4.3	2.7	2.3	2.4	3.1	-0.3	-0.6
High-income countries	3.3	1.6	1.3	1.3	2.0	-0.2	-0.6
Developing countries	7.5	5.9	5.1	5.5	5.8	-0.4	-0.2

Source: World Bank data and staff estimates.



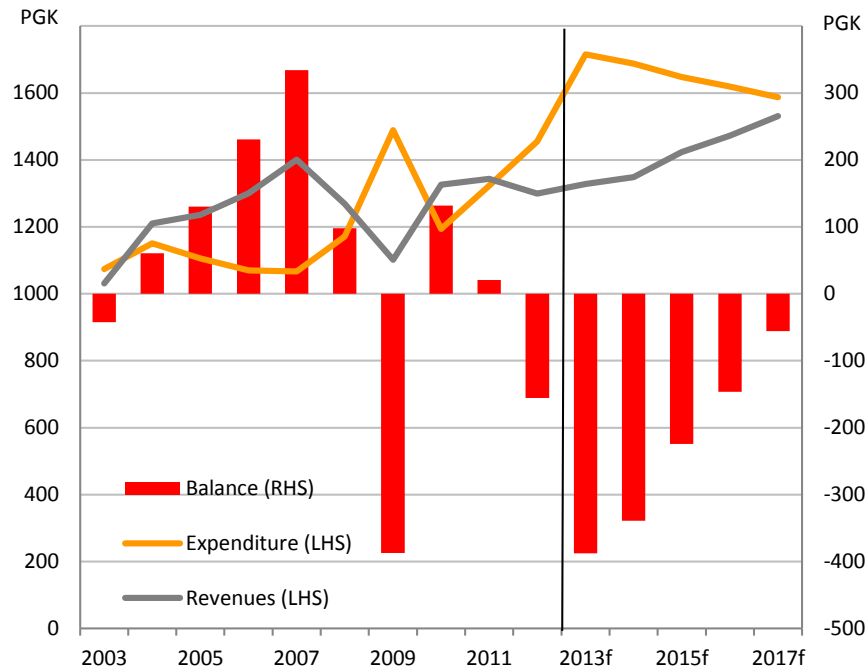
Broadening and extending the boom

Broadening and extending the boom

Using public spending to inject new demand into the economy

- ▶ After several years of strong growth, the 2013 budget targets a new, short-term impulse to take per-capita spending to its highest ever

(real spending and revenues per person, constant 2012 Kina*)

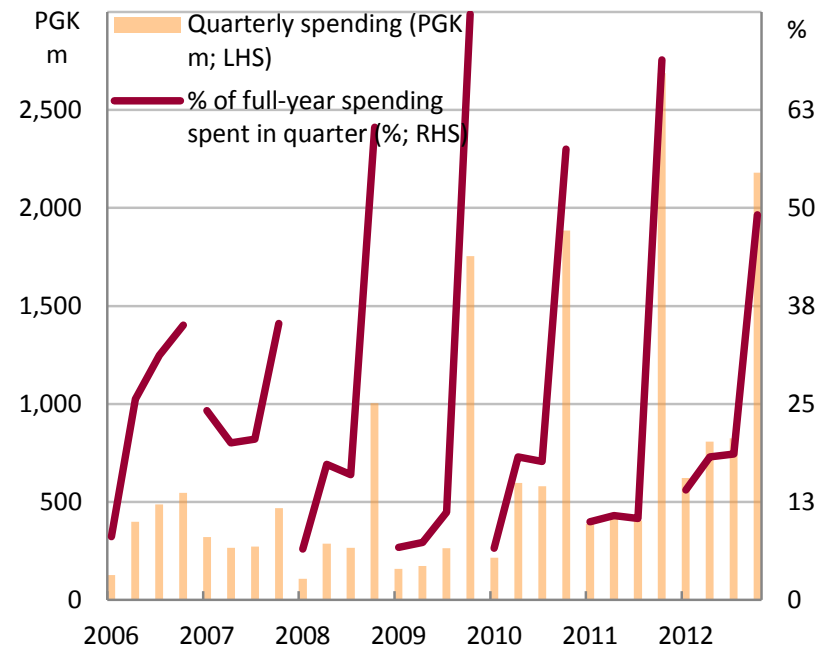
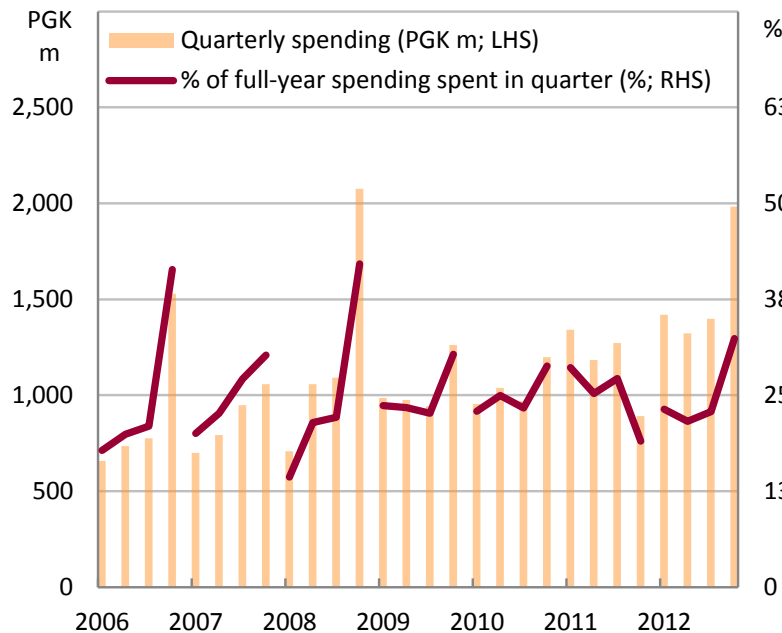


Broadening and extending the boom

Searching to overcome the weaknesses in current systems

- ▶ **87% increase in transfers to local and district governments, to K 1.5 billion**
 - ▶ Transferring spending from national authorities to local agencies
- ▶ **50% increased allocations to development enablers, including fee subsidies**

Spending the budget over the course of the year: Recurrent Development

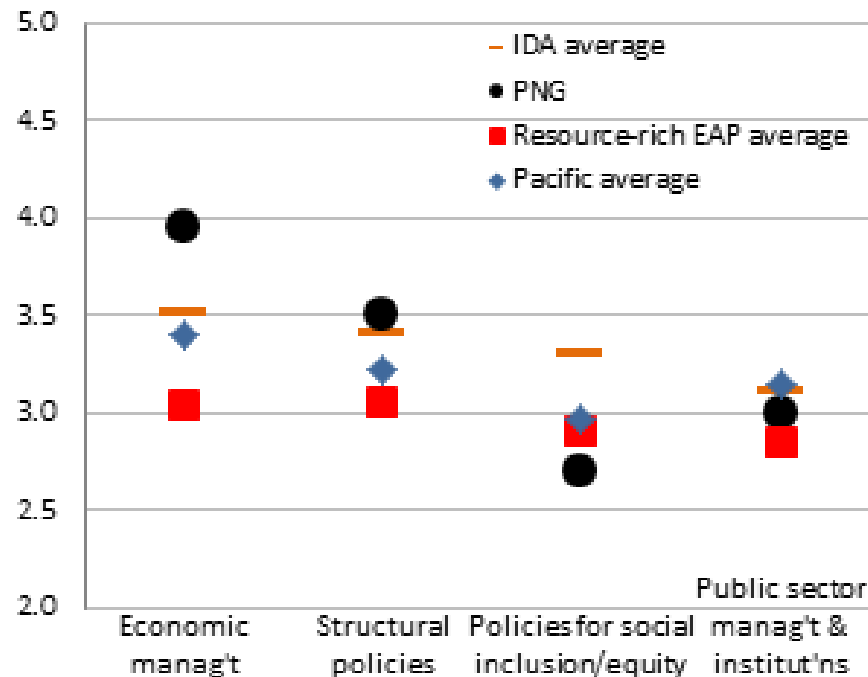


Broadening and extending the boom

Great scope to improve the effectiveness of public institutions at providing decentralized services and social protection

Assessment of how well a country's policies and institutions transform resources into sustainable economic development, across four dimensions

(higher scores indicate better performance)

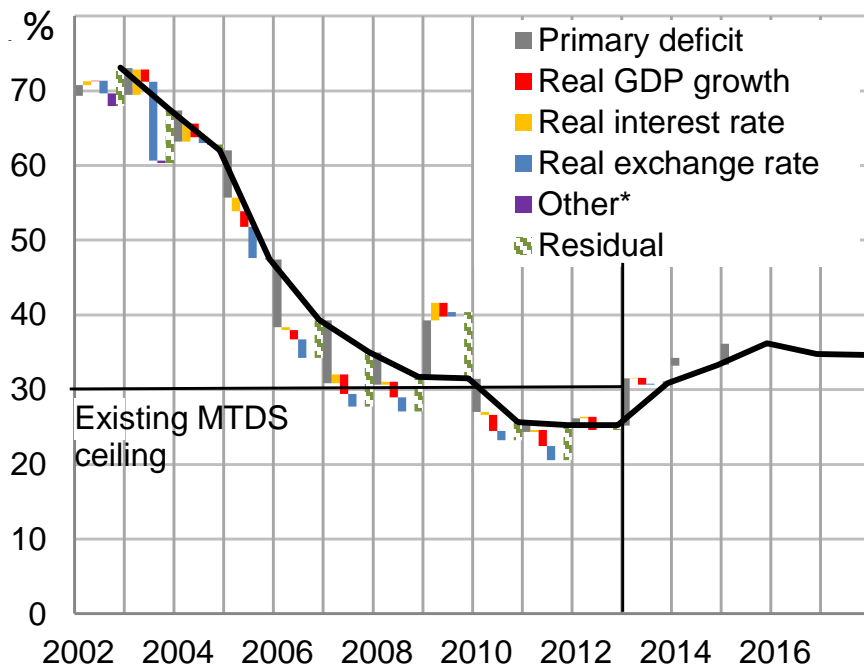


Broadening and extending the boom

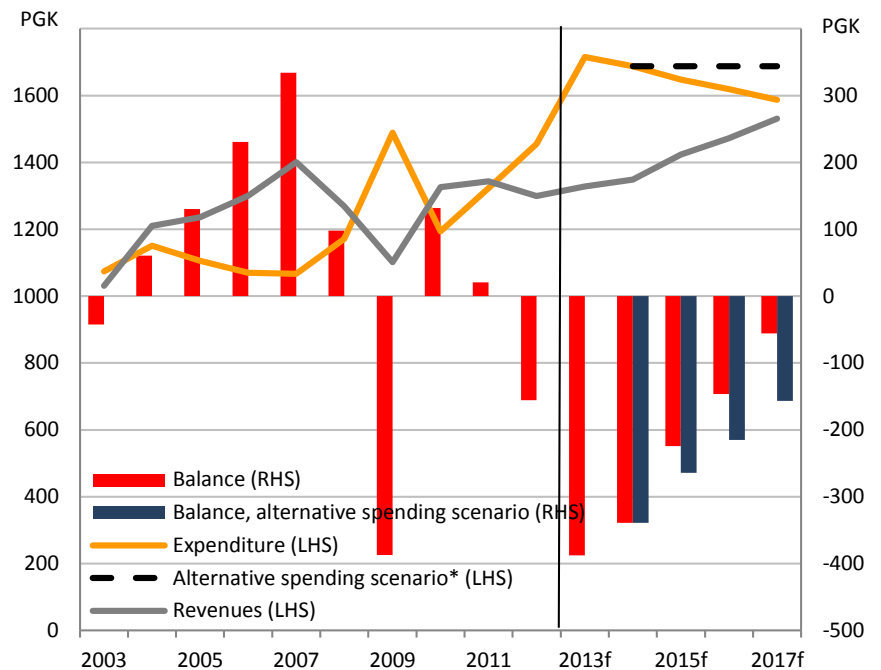
But there are risks that the past decade's gains in public finances are unwound

Some reversal of the recent improvements in public finances

(public debt and its drivers, percent of GDP
not including contingent and off-balance-sheet liabilities, currently near 20% of GDP)



...and risk of difficulty unwinding new expenditure risks maintaining larger deficits and debt

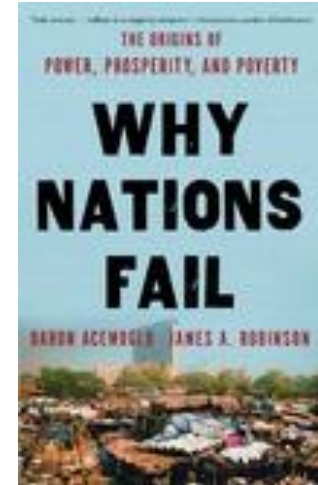


The deeper challenges of resource-heavy growth

Why deliver quality services when incentives are weak?

The thesis of *Why nations fail* (Acemoglu & Robinson, 2012):

- ▶ This is a primer of the **risks** with concentrated, extractive-sector driven growth (**NOT** where PNG is today...)
- ▶ Economies **dominated by a few extractive** economic sectors tend to have **more extractive political institutions**
- ▶ These rarely encourage innovation to be rewarded, and growth to become sustained and broadly-based
- ▶ **The incentives** for policy makers to provide quality public services are weak
 - ▶ Few citizens pay taxes, and so weaker incentive to demand public services
 - ▶ A small elite can do better under an extractive status quo than the more inclusive alternative
- ▶ While PNG's recent boom is notable for the breath of growth across sectors, much has been linked to a few, narrow investments, or the reforms of the early 2000s
 - ▶ Risks are likely to be greater when sectors become more capital- or low-skill-labor intensive – these are less inclusive

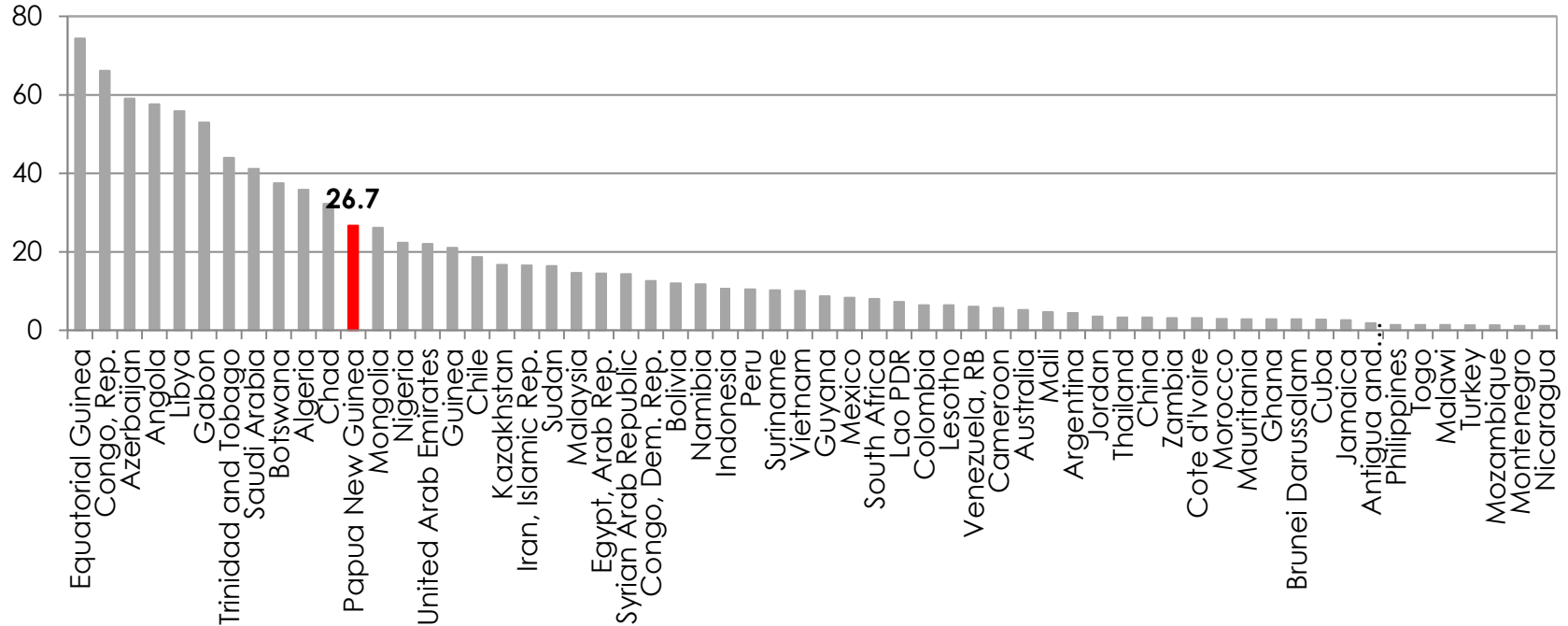


The deeper challenges of resource-heavy growth

Resources are important for PNG, but we should not over-state the reliance

Average 2005-2009 Mining and Quarrying¹ as percentage of GDP in countries with a share higher than 1%

Percent of Total GDP

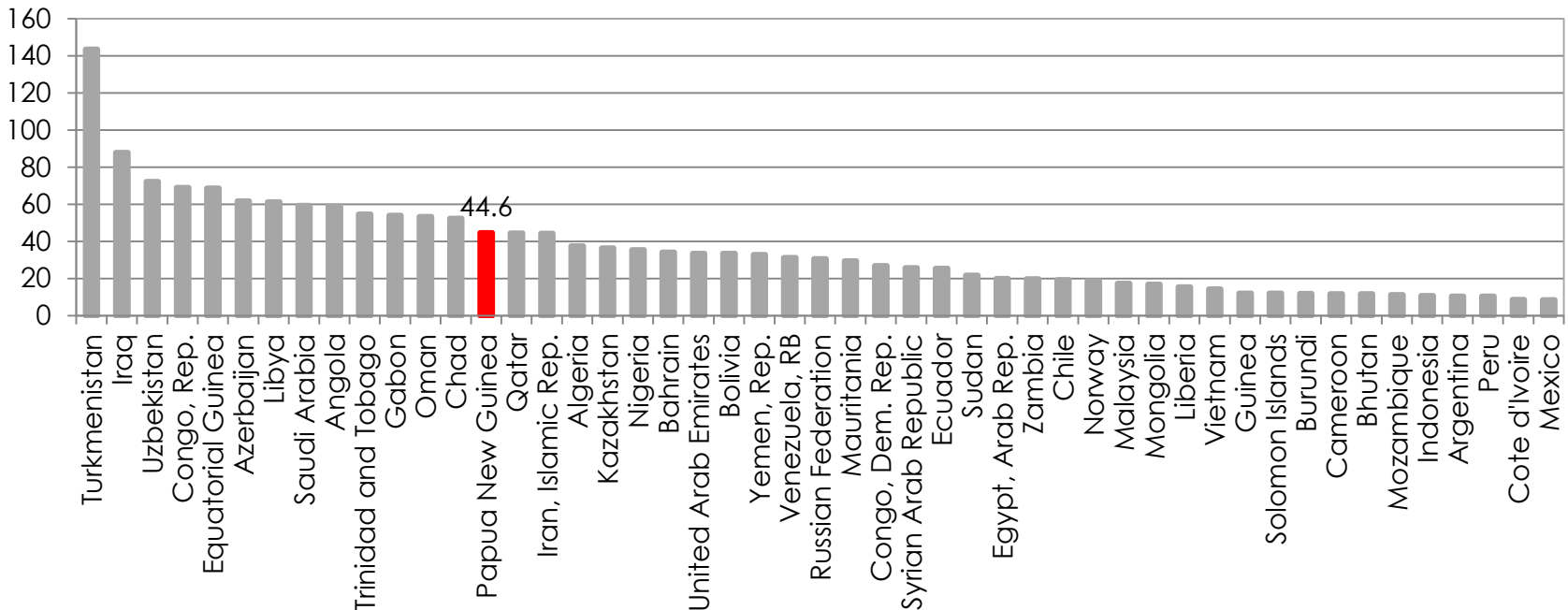


The deeper challenges of resource-heavy growth

What's the cross-country evidence?

Total Natural Resources Rents Average 2005-2009

Percent of Total GDP

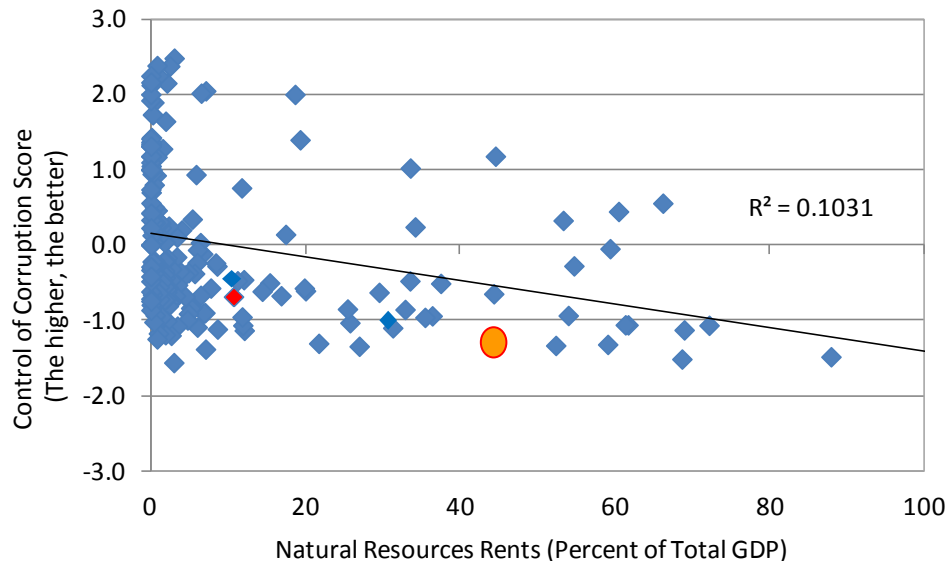


The deeper challenges of resource-heavy growth

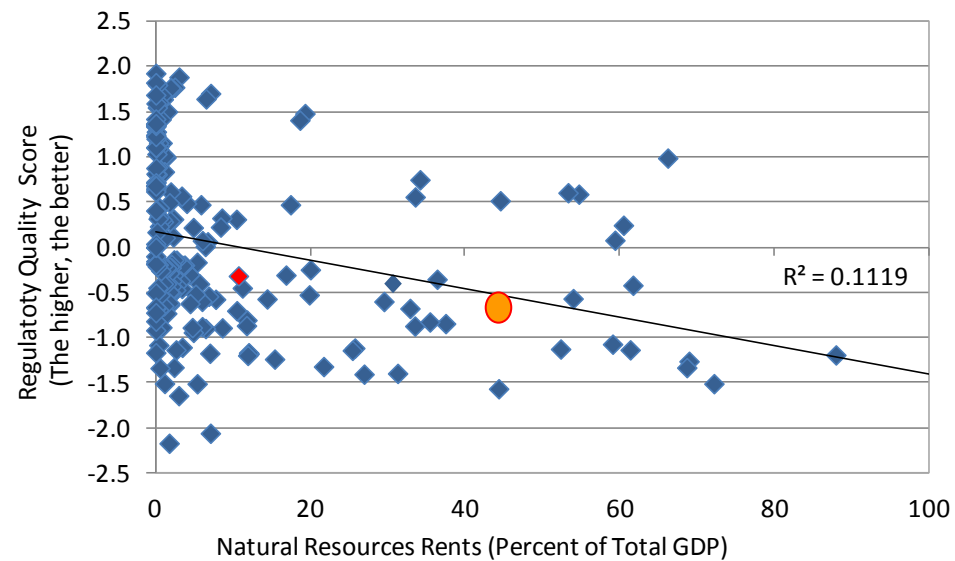
What's the cross-country evidence?

The quality of all the different dimensions of governance is negatively correlated with the importance of natural resources

Control of Corruption



Regulatory Quality

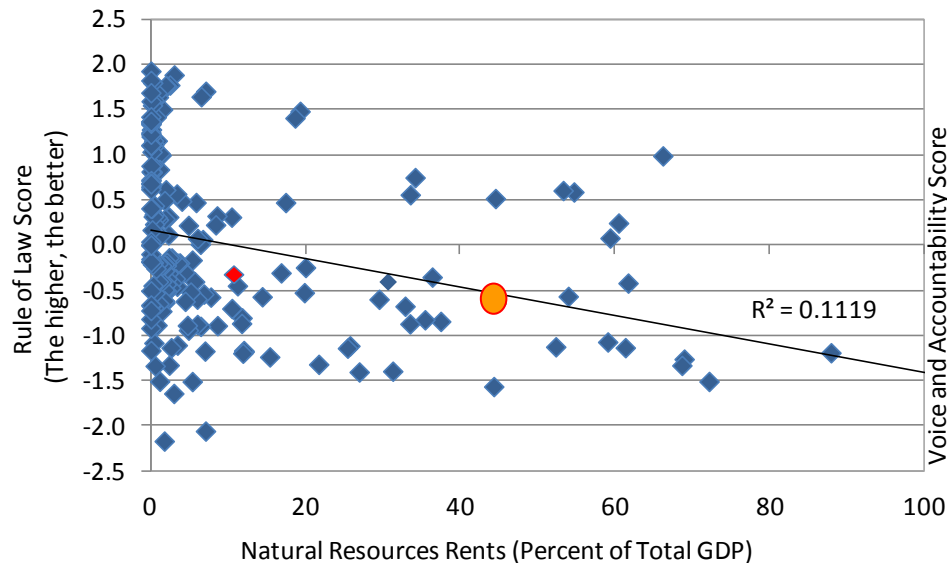


The deeper challenges of resource-heavy growth

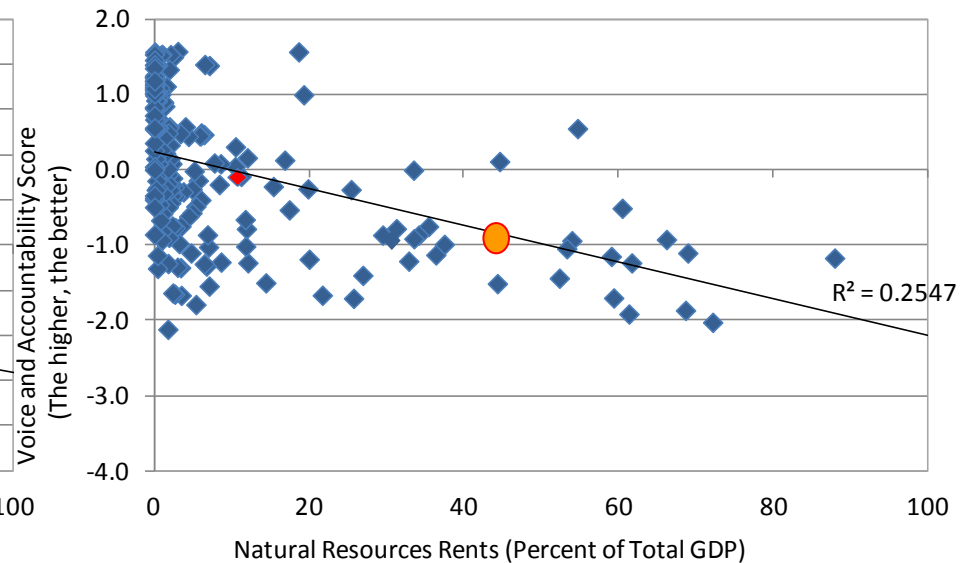
What's the cross-country evidence?

The quality of all the different dimensions of governance is negatively correlated with natural resources

Rule of Law



Voice and Accountability



**Turning the boom into sustained improvements in living standards
by doing things smarter**

Great scope to raise living standards by changing how things are done

Strategic regulatory reforms can be the best support for PNG businesses

While PNG ranks relatively well on a few indicators, in most areas regulation is holding PNG businesses back

(ranking of PNG, out of 185 countries)

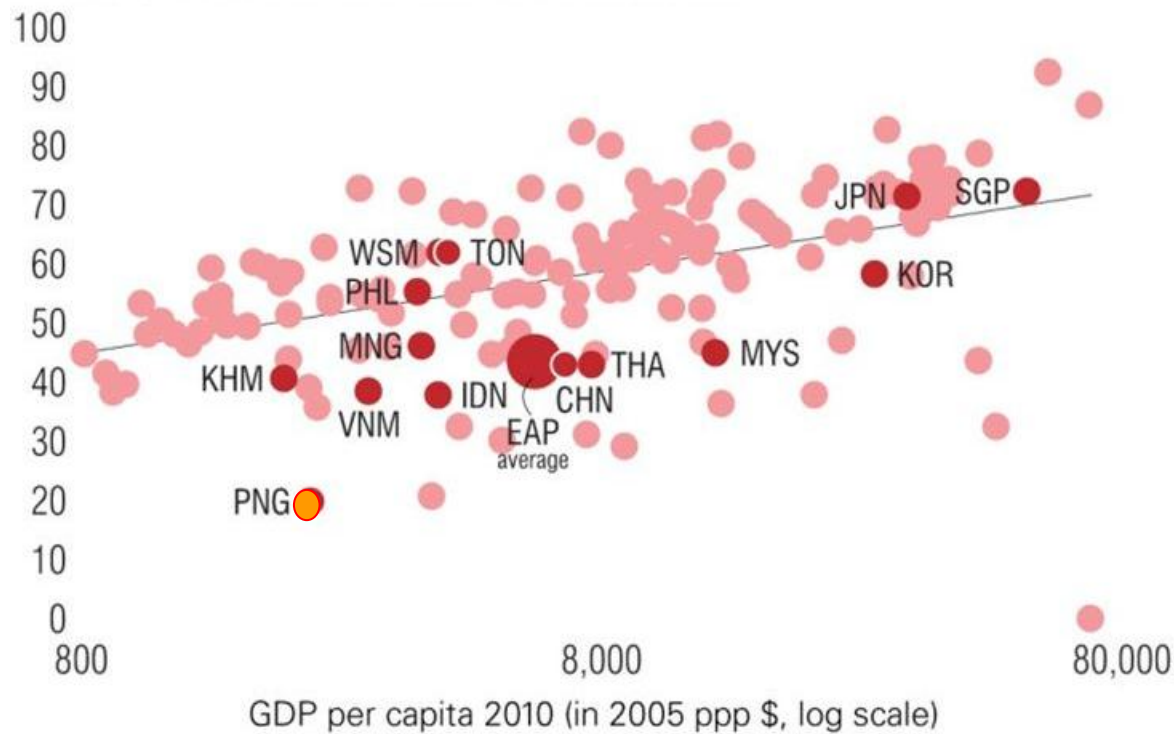
Starting a business	Dealing with construct'n permits	Getting electricity	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
91	159	23	88	83	49	106	120	166	125

- ▶ **Small and medium enterprises are the largest source of employment and incomes across the world**
- ▶ **Closing markets to competition and providing subsidies is not a long-term solution to encouraging locally owned businesses in PNG.**
 - ▶ Rather than working to reduce competition, policy makers' efforts would more effectively bring sustained improvements in living standards by working to improve - owned businesses ability to compete.
- ▶ **The kinds of reform that will reduce costs for PNG businesses and increase their competitiveness are not expensive, and they are not difficult.**
 - ▶ Some key reforms are already underway
- ▶ **Business-enabling reforms provide an environment that will increase the impact of the government's wider reforms, and help PNG-owned businesses to can make the most of the spin-off opportunities presented by large investment projects**



Great scope to raise living standards by changing how things are done
Eg, services lag generally in East Asia/Pacific, but even more so in PNG

(Services as a share of GDP, and per capita income)



Great scope to raise living standards by changing how things are done

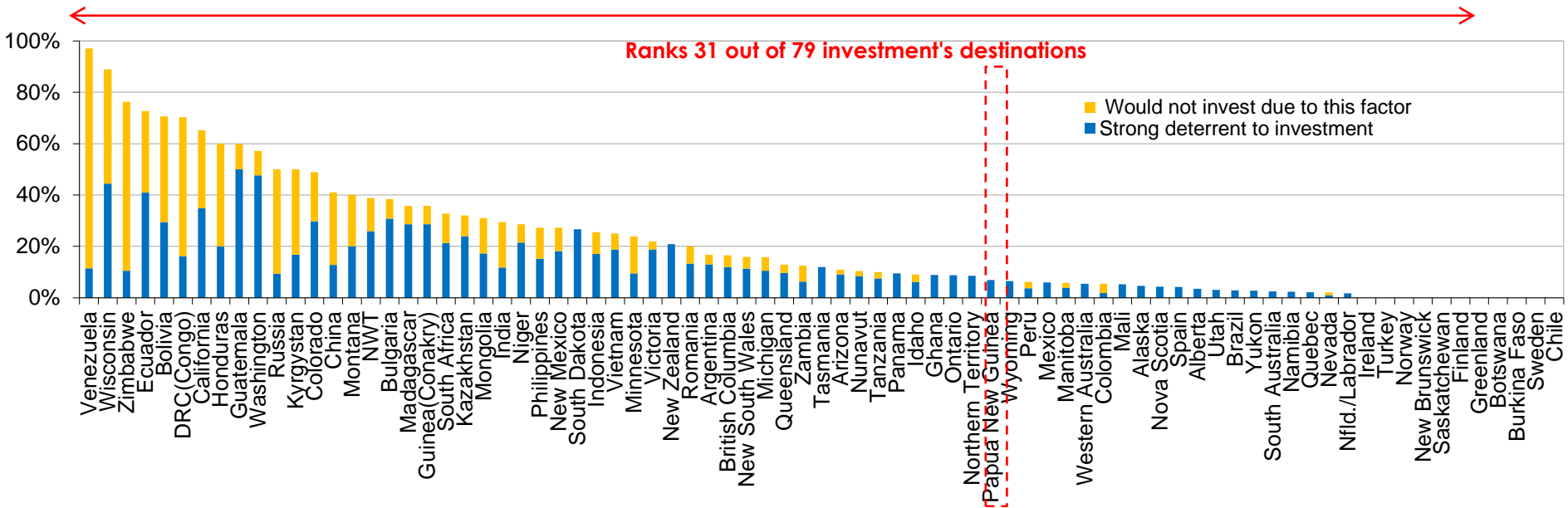
PNG already seems to design and implement regulations well in the mining sector

How much of a deterrent for investment is the degree of uncertainty regarding the administration, interpretation and enforcement of regulations?

(Percent of respondents)

Worst Investment Climate

Best Investment Climate



Great scope to raise living standards by changing how things are done

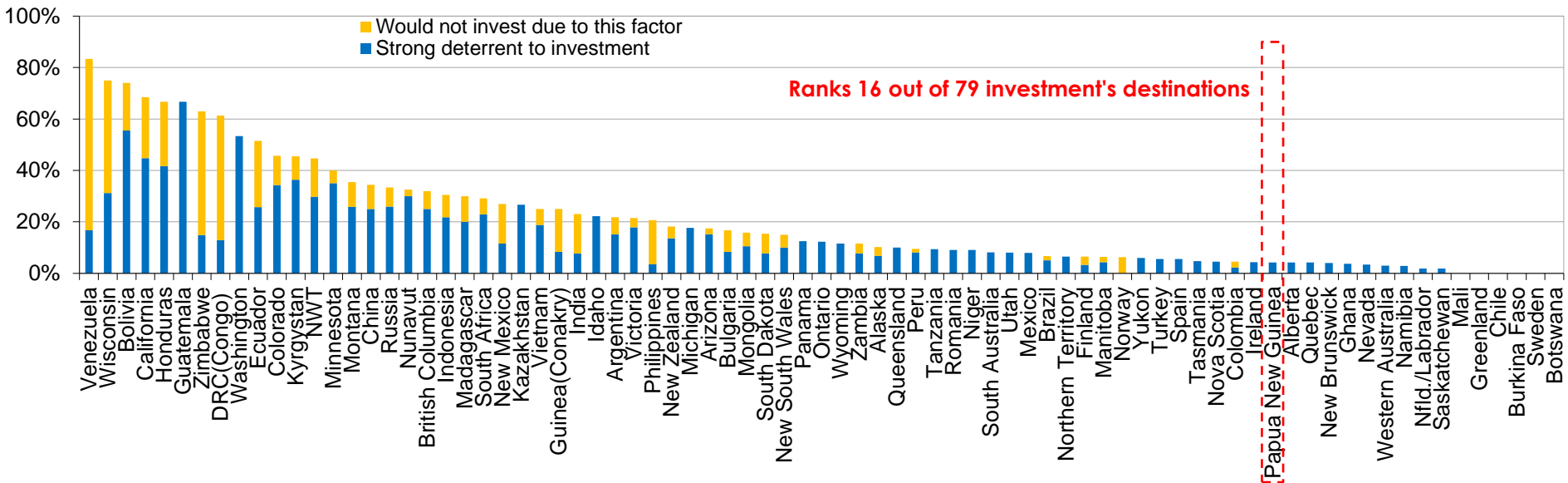
PNG already seems to design and implement regulations well in the mining sector

How much of a deterrent for investment is the degree of regulatory duplication and inconsistencies?

(Percent of respondents)

Worst Investment Climate

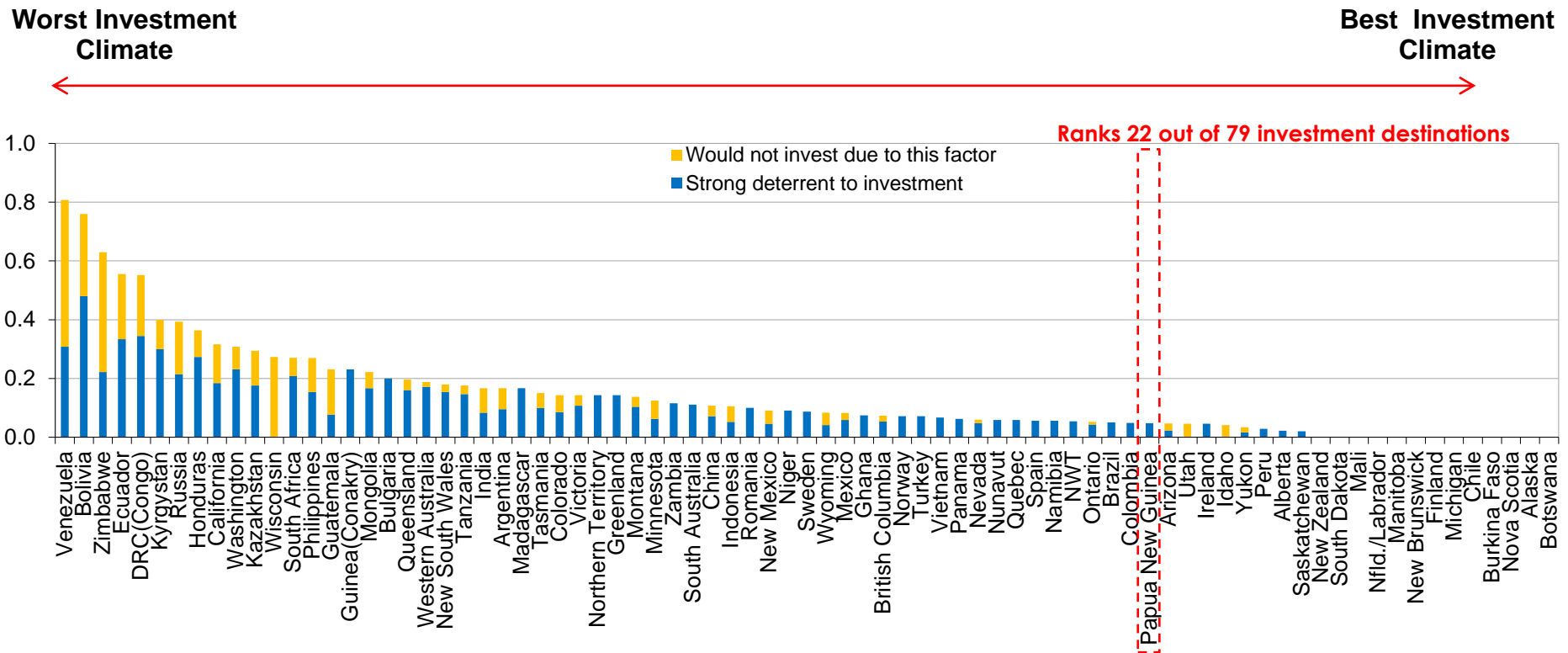
Best Investment Climate



Great scope to raise living standards by changing how things are done

PNG already seems to design and implement regulations well in the mining sector

How much of a deterrent for investment is the tax regime? (Percent of respondents)



The challenge of turning the last days of the boom into lasting improvements in living standards

1. PNG has enjoyed a transformational decade – but the **drivers are coming to an end**
2. The government is looking to extend this boom and spread the benefits more widely
 - ▶ But the delivery mechanisms are imperfect...
 - ▶ and attention must be paid to overall **fiscal sustainability** if PNG is to avoid the experience of the 1990s
 - ▶ Many countries have found large resource sectors make it harder to do what the government is trying to do – providing better public services to more Papua New Guineans
3. So the focus needs to be on doing things smarter:
 - ▶ Making the **business climate more supportive** of Papua New Guinean businesses, especially those outside the resource sector
 - ▶ More supportive regulation can help businesses more than protecting established players and reducing competition
 - ▶ Good regulatory reforms make the government's other reforms and opportunities more effective
 - ▶ PNG has shown it can make key reforms and make do this in some key areas



Papua New Guinea Economic Briefing

The challenge of turning the last days of the boom into lasting improvements in living standards

Tim Bulman

Country Economist

The World Bank in Papua New Guinea

Jonathon Kirkby

Senior Investment Policy Officer, Investment Climate

The International Finance Corporation in Papua New Guinea

December 19, 2012

XXXX, Port Moresby

www.worldbank.org/png



The World Bank Group
in Papua New Guinea